No. 93-489

In The

SUPREME COURT OF THE UNITED STATES

October Term, 1993

O'Melveny & Myers, A Law Partnership,

Petitioner,

v.

Federal Deposit Insurance Corporation As
Receiver For American Diversified Savings Bank, et al.,

Respondents.

Petition for a Writ of Certiorari
To the United States Court of Appeals
For the Ninth Circuit

BRIEF AMICUS CURIAE BY BUSINESS LAWYERS IN SUPPORT OF PETITIONER

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I. INTEREST OF AMICI CURIAE

Pursuant to Rule 36.1 of Rules of this Court, this brief amicus curiae is being submitted by counsel experienced in business and securities law to urge the

Court to grant the petition of O'Melveny & Myers (the "Firm") for the issuance of a writ of certiorari to review the decision of the Ninth Circuit in FDIC v. O'Melveny & Meyers [sic], 969 F.2d 744 (1992) (hereinafter, "O'Melveny" or the "Decision").[1] The articulated premise of the Ninth Circuit's opinion rejecting the Firm's claims of estoppel is that the Firm owed a duty to the investors in the partnerships organized by the Firm's client to conduct a due diligence investigation of the offering circulars used to offer and sell interests in the partnerships. No such duty exists. The Ninth Circuit's articulation of this purported principle of law is at odds with rulings on the issue in the Second, Fourth, Fifth, Seventh, Eighth, and Tenth Circuits.

Were the Ninth Circuit's pronouncements on the duties of securities counsel to become the law of the Ninth

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[1] The firms joining in the request made by this brief are listed on the signature page hereto.

Circuit, securities counsel would be shouldered with a burden they realistically cannot bear. Inevitably, only the largest firms could continue with a securities practice, and then only at a cost to issuing companies that would make it much more difficult for smaller companies to access the capital markets.

The undersigned have sought and obtained the consent of both petitioner and respondents to the filing of this brief urging the Court to accept the Firm's petition for a writ of certiorari. The consent letters are being filed with the signed original of this brief.

II. STATEMENT

This lawsuit arose from the ashes of two partnerships that were terminated shortly after their organization, upon the FDIC's discovery that the private placement memoranda used to market the two partnerships omitted material facts, primarily regarding the financial condition of American Diversified Savings

Bank ("ADSB"), the corporate parent of the general partners of the partnerships. The Firm assisted the general partner in drafting the two private placement memoranda. No contention is made that the Firm had knowledge of the facts omitted from the private placement memoranda.

The source of the fraud can be traced to the feet of the two principal officers of ADSB. The focus of the litigation became, therefore, whether the FDIC was estopped from asserting its claims of professional malpractice, negligent misrepresentation, and breach of fiduciary duty against the Firm by the misconduct of these two principal officers. The District Court ruled that the FDIC's claims were extinguished by the officers' misconduct; the Ninth Circuit ruled they were not.

Fundamental to the Ninth Circuit's conclusion, and the premise from which it launched into its analysis of the estoppel issues, are its observations and pronouncements

on the duties of securities counsel. While arguably these observations and pronouncements are *dicta*, in that the question of the duties of securities counsel to investors was not presented to the Ninth Circuit, because the pronouncements are so fundamental to the Court's rulings, so wrong, and may be accepted as controlling by lower courts throughout the Ninth Circuit, they constitute an independent ground on which this Court should grant the Firm's petition to issue a writ of certiorari to review the Decision.

Before the Ninth Circuit, the FDIC argued that it was axiomatic that the Firm, as securities counsel, was duty bound to ensure that ADSB's private placement memoranda were true and complete:

> O'Melveny had a duty, as securities counsel to ADSB, to use due care to learn readily available material facts about ADSB and to cause those facts to be disclosed to potential investors. While there was unquestionably wrongdoing by some insiders at ADSB, this wrongdoing in no way prevented O'Melveny from doing its job. Had O'Melveny

done its job properly, the losses to ADSB and to the investors would not have occurred.[2]

The FDIC relied heavily upon Judge Smith's 1978 opinion for the Northern District of Mississippi in Felts v. National Accounts Systems Ass'n, Inc., 469 F. Supp. 54 (N.D. Miss 1978) ("Felts"), wherein Judge Smith ruled that securities counsel has a duty "to exercise due diligence, including a reasonable inquiry, in connection with responsibilities he has voluntarily undertaken." *Id.* at 67. Citing Judge McLean's famous opinion in Escott v. BarChris Construction Corp., 283 F. Supp. 643 (S.D.N.Y. 1968) ("BarChris"), Judge Smith concluded that securities counsel must make a "reasonable, independent investigation to detect and correct false or misleading materials." *Id.*

The Ninth Circuit, in its opinion by Judge Poole,

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[2] Appellants' Opening Brief Before the Ninth Circuit, dated October 31, 1990, at 2-3.

adopted the argument of the FDIC. Seizing upon a hypothetical statement by the Firm that, even if securities counsel owes a duty of due diligence to investors, it owes *no* such duty to the issuer under the circumstances present in this case, Judge Poole concluded that if securities counsel owes a duty of due diligence to investors, it must also owe a duty of due diligence to its client -- the issuer. O'Melveny "concedes," states Judge Poole, "the existence of a duty by a principal and its agent of complete and accurate disclosure to potential investors in a securities offering, but argues . . . that the agent owes no additional duty to the successor in interest of a principal to make inquiries and disclose information which, the Firm argues, the principal already knew and was trying to conceal." 969 F.2d at 748. Whatever force this argument had, the Ninth Circuit simply could not stomach the claim when made against the government agency "created by Congress to rescue the economy and the victims of failing thrifts. . ."

Id. That the FDIC should be frustrated in rescuing the economy by the fraud committed by prior management of a thrift was a proposition found "incredible" by the Ninth Circuit, particularly when applied "to the duties of attorneys retained to give advice and assistance with respect to public offerings." *Id.*

Hewing closely to the line of argument pressed upon it by the FDIC, the Ninth Circuit refused to accept the distinction between counsel's duty to investors and counsel's duty to its client:

> Given a broad duty to protect the client, this distinction [between the duty to investors and the duty to the client] is a false one. Part and parcel of effectively protecting a client, and thus discharging the attorney's duty of care, is to protect the client from the liability which may flow from promulgating a false or misleading offering to investors. An important duty of securities counsel is to make a "reasonable independent investigation to detect and correct false or misleading materials." [citing Felts] This is what is meant by a due diligence investigation. Koehler v. Pulvers, 614 F. Supp. 829, 845 (S.D. Cal. 1985) (due diligence required lawyer's independent investigation of information supplied by issuer for incorporation

> into offering materials.) The Firm [O'Melveny] had a duty to guide the thrift as to its obligations and to protect it against liability. In its high specialty field, O'Melveny owed a duty of due care not only to the investors, but also to its client, ADSB.

969 F.2d at 749.

III. ARGUMENT

A. THE NINTH CIRCUIT'S PRONOUNCEMENTS ON THE DUTIES OF SECURITIES COUNSEL ARE AT ODDS WITH RULINGS OF THE SECOND, FOURTH, FIFTH, SEVENTH, EIGHTH, AND TENTH CIRCUITS

The fullest treatment of the duties of securities counsel to investors or to third parties other than counsel's client can be found in Judge McLean's opinion in BarChris, *supra* at page 6, in the Fourth Circuit's opinion in Schatz v. Rosenberg, 943 F.2d 485 (4th Cir. 1991), *cert. denied*, 112 S. Ct. 1475 (1992), and in the Seventh Circuit's decision in Barker v. Henderson, Franklin, Starnes & Holt, 797 F.2d 490 (7th Cir. 1986). These and the other cases that have addressed the question establish that

counsel is not liable for the misstatements of fact by others unless counsel has a specific duty to investigate a client's statement of facts *and* a duty to disclose the results of that investigation. No such duty to investigate the veracity of the representations of fact contained in an offering circular is imposed upon counsel by Sections 11 or 12 of the Securities Act of 1933, as amended (the "Securities Act"), 15 U.S.C. §§ 77k, 77*l* (1988), or by Section 10(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), 15 U.S.C. § 78j(b) (1988) or Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 (1993). *See* Fortson v. Winstead, McGuire, Sechrest & Minick, 961 F.2d 469, 472-475 (4th Cir. 1992); Ackerman v. Schwartz, 947 F.2d 841, 844-848 (7th Cir. 1991); Camp v. Dema, 948 F.2d 455, 459-461, 463-464 (8th Cir. 1991); Abell v. Potomac Insurance Co., 858 F.2d 1104, 1123-1128 (5th Cir. 1988), *vacated on other grounds*, 492 U.S. 914 (1989). *See also* Windon Third Oil and Gas

Drilling Partnership v. FDIC, 805 F.2d 342, 346-347 (10th Cir. 1986) *cert. denied*, 480 U.S. 947 (1987) (accountants owe no duty of due diligence to an issuer's investors under Rule 10b-5).[3]

The rulings in each of these cases are directly contrary to the pronouncements of the Ninth Circuit in O'Melveny that securities counsel has a duty to make a

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[3] A lawyer may, of course "expertise" portions of a registration statement, such as by the issuance of a tax opinion, in which event counsel would take on the responsibilities of an expert pursuant to Section 11 of the Securities Act, 15 U.S.C. § 77k. *See* Judge McLean's discussion of this issue in BarChris, *supra* page 6, 283 F. Supp. at 683.

The only circuit in which one can find an echo of support for the Ninth Circuit's pronouncements on the duties of securities counsel in O'Melveny is the Sixth Circuit's opinion in Molecular Technology Corp. v. Valentine, 925 F.2d 910 (6th Cir. 1991), wherein the Court, without citation, pronounces that securities counsel owes a duty under Rule 10b-5 to disclose to investors material facts of which counsel is *aware* in connection with counsel's review of a prospectus prepared by other counsel. *See id.* at 917-918.

"reasonable independent investigation to detect and correct false or misleading materials." 969 F.2d at 749 (citing Felts). The rulings in these cases contradict the Ninth Circuit even though in most of them the allegation was made that counsel had *some knowledge* of the inaccuracy of the prospectus or transaction documents; here, no allegation has been made that O'Melveny had any knowledge of the precarious financial condition of ADSB, the source of the misstatements in the two private placement memoranda the Firm assisted the partnerships in preparing.

B. THE TWO FEDERAL DECISIONS ON WHICH THE NINTH CIRCUIT RELIED TO REACH ITS CONCLUSION ON THE DUTIES OF SECURITIES COUNSEL DO NOT SUPPORT ITS CONCLUSION

The Ninth Circuit relies on two Federal decisions in concluding that securities counsel owes a duty of due diligence to investors, Felts and Koehler v. Pulvers, cited *supra* at pages 5-6 and 9. In Felts Judge Smith misread

Judge McLean's ruling in BarChris. Indeed, Judge Smith turned Judge McLean's ruling on the duties of securities counsel on its head. Judge McLean ruled that an issuer's securities counsel is *not* an expert for purposes of Section 11 of the Securities Act, and therefore has no duty to conduct a due diligence investigation of the registration statement. 283 F. Supp. at 683.

Judge Enright's opinion in Koehler v. Pulvers, 614 F. Supp. 829 (S.D. Cal. 1985) likewise provides no support for the Ninth Circuit's opinion. Despite extensive evidence of counsel's direct and purposeful participation in marketing securities, and knowledge that the private placement memorandum was materially misleading, Judge Enright nevertheless concluded that counsel did not possess the requisite scienter for liability under Rule 10b-5. 614 F. Supp. at 836, 838-840, 845-848. Koehler cannot be read as imposing a duty of due diligence upon securities counsel.

C. THE NINTH CIRCUIT'S PRONOUNCEMENTS ON THE DUTIES OF SECURITIES COUNSEL FINDS NO SUPPORT IN CALIFORNIA LAW

Space limitations prevent a detailed critique of the Ninth Circuit's ruling on the duties of securities counsel under California state law. Suffice to say that these pronouncements find no support under California statutory or case law. *See* 1 H. Marsh and R. Volk, Practice Under The California Securities Laws §§ 14.03[4], [4A] (1993); Goodman v. Kennedy, 18 Cal. 3d 335, 134 Cal. Rptr. 375 (1976); Roberts v. Ball, Hunt, Hart, Brown & Baerwitz, 57 Cal. App. 3d 104, 128 Cal. Rptr. 901 (2nd Dist. 1976). *See also* Bily v. Arthur Young & Company, 3 Cal. 4th 370, 11 Cal. Rptr. 2d 51 (1992). For a detailed discussion, see Fotenos, "FDIC v. O'Melveny & Myers: Does Securities Counsel Owe To Investors and To Its Client a Duty To Conduct a Due Diligence Investigation of the Offering?", 15 Bus. Law News 3, 40-43 (Cal. State Bar, Business Law Section, Winter 1993).

D. THE NINTH CIRCUIT'S PRONOUNCEMENTS ON THE DUTIES OF SECURITIES COUNSEL WILL HAVE A DELETERIOUS EFFECT UPON THE PRACTICE OF SECURITIES LAW, AND CAPITAL FORMATION, IN THE NINTH CIRCUIT

The burden of conducting a due diligence investigation of a securities offering is one that securities counsel to an issuer cannot realistically shoulder. Congress is quite specific, in Section 11 of the Securities Act, as to who is responsible for conducting a due diligence investigation of a securities offering: the underwriter and those who sign the registration statement (the chief executive, financial, and accounting officers and the directors). Experts who specifically prepare a portion of the registration statement or an opinion incorporated therein are assigned due diligence responsibilities with respect to those portions of the registration statement prepared by them or with respect to the opinion rendered

by them.[4] Each of these parties is uniquely situated to bear the responsibility of conducting a due diligence investigation of the offering. Underwriters maintain extensive research staffs, which continually monitor the industries in which their clients operate, and the specific business of their clients (or potential clients). Officers spend their full time in the business of the issuer. Directors have a continuing involvement with the business of the issuer, and gain intimate knowledge thereof through the discharge of their oversight responsibilities.

Securities counsel is retained not to conduct a factual investigation of an issuer's business, but to assist the issuer in wending its way through the complicated statutory requirements and rules governing the preparation of a registration statement and the offer and sale of

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[4] As indicated above at pages 12-13, the fact that counsel may assist the issuer in drafting a registration statement does not make counsel a statutory expert for purposes of Section 11.

securities. In this, counsel plays an advisory role, leaving to the issuer and its officers and employees the task of providing accurate information about the issuer's business and the risks attendant to operating that business. Often in the process of preparing a registration statement, an issuer's counsel may negotiate for the issuer with the underwriter and with the underwriter's counsel over disclosure questions.

Imposing upon securities counsel a due diligence obligation not found in existing law would upset the delicate balance crafted by Congress in allocating due diligence obligations, and would disrupt the capital formation process.[5] If securities counsel is to be held to

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[5] The imposition of a broad duty of verification is not in accordance with present practice and would not only constitute a wasteful use of the attorney's professional talents, but might also impose economically unfeasible burdens on the client.

(*cont.*)

a due diligence obligation, then such counsel will of necessity focus its energy not only upon assisting its client, but also upon building a record to insulate itself from potential liability. In the process, counsel's duty of maintaining in confidence information relating to the representation may be compromised.[6]

Not only would the practice of securities law have to change dramatically if the Ninth Circuit's pronouncements on the duties of securities counsel establish the law in the Ninth Circuit, but inevitably the substantially increased risk to counsel would limit the practice only to the largest firms or those firms heedless

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Small, "An Attorney's Responsibilities Under Federal and State Securities Laws: Private Counselor Or Public Servant?" 61 Cal. L. Rev. 1189, 1214 (1973).

[6] *See* ABA, Model Rules of Professional Conduct, Rule 1.6, and ABA, Model Code of Professional Responsibility, Canon 4 and Disciplinary Rule 4-101; Cal. Bus. & Prof. Code § 6068(e) (West 1990).

of risk. A necessary further consequence would be to increase the cost of accessing the capital markets by issuers of securities. Neither of these consequences is desirable.

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IV. CONCLUSION

For the foregoing reasons, the undersigned urge the Court to grant the petition by O'Melveny & Myers for a writ of certiorari.

Dated: October 26, 1993

Respectfully submitted,

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